

Exhibit D – Part I

Testimony of Broder

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THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-509
OIG-509)

2063

PAGES: 1 through 38
PLACE: Renaissance Technologies Corporation
800 Third Avenue, No. 34
New York, New York 10022
DATE: Thursday, March 12, 2009

The above-entitled matter came on for hearing, pursuant
to notice, at 12:00 p.m.

TAPE TRANSCRIPTION

Diversified Reporting Services, Inc.

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2

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P R O C E E D I N G S

1
2 MR. KOTZ: Thanks for talking. Let me just kind of
3 give a real brief background. My job as the Inspector
4 General is to look into the interactions between the SEC and
5 Madoff Securities over time. And there were, you know, a
6 variety of different areas in which the SEC looked at,
7 whether it was through examinations or investigations.

8 And so, you know, what we're doing is tracing back
9 what information the SEC had, what information they obtained,
10 and why did they not come to a conclusion of a concern about
11 Madoff. And so, you know, what we're trying to get here is
12 information, really, that would lead us to understand what a
13 regulator should do.

14 So just to kind of be clear, obviously you all were
15 in a very different situation than the SEC would be. I mean,
16 you are in a situation where you were looking things for your
17 own investment purposes. And so there's, you know, different
18 kind of responsibilities with respect to that.

19 So we're not trying to kind of give them impression
20 that, you know, you should have done this or you should have
21 done that. What we're trying to understand is if you were in
22 a situation like you were in where you were obtaining
23 information without the ability of the SEC to compel,
24 subpoena, things like that, based upon the information that
25 you saw, what your conclusions or concerns were to. And then

1 we're trying to understand what a regulator could or should
2 have done with that to follow up further.

3 And also, based on the information that came in
4 that you had that was in this e-mail that then got to the
5 SEC, what should the SEC have done in order to follow up on
6 that to get to a point where this could have been uncovered.

7 And so, you know, we're looking at all kinds of
8 different aspects of this. This is, you know, I would say a
9 significant but small aspect of it because, you know, there
10 were numerous other pieces of information that came in to the
11 SEC that were specific complaints, you know, in great detail,
12 like Harry Markopolos. I don't know if you read about him.

13 MR. BRODER: Right.

14 MR. KOTZ: You know, and that was brought to the
15 Enforcement Division, you know, where they have subpoena
16 power, et cetera. But nevertheless, you know, the SEC is
17 charged with having the ability and expertise to look at
18 potential red flags and then follow up appropriately to
19 determine if anything happened.

20 And what happened here was there were several
21 efforts to review and examine and investigate. There was
22 significant time, at least, spent by the SEC involved in this
23 process. And yet they didn't come to a conclusion of really
24 any significant violations at all. And then of course, we
25 found out in December -- you know, Madoff came forward --

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1 that, you know, this thing was, you know, an illegal action.

2 So what we're trying to do is trace back what
3 information did the SEC have and, you know, what should they
4 have made of it. So in this, I want to just, you know, kind
5 of start by asking a few questions, a little bit about your
6 background, and then just kind of get into, you know, some of
7 the information of what you found and then, you know, maybe
8 ask you your opinion on how a regulator could or should
9 follow up based on that. All right?

10 MS. STEIBER: Please state your name.

11 MR. BRODER: It's Paul Broder, B-r-o-d-e-r.

12 MR. KOTZ: Okay. And so you are an investment
13 manager?

14 MR. BRODER: Correct.

15 MR. KOTZ: And how long --

16 MR. BRODER: I guess I'm the risk manager, but --

17 MR. KOTZ: Okay. How long have you been in that
18 position with Renaissance?

19 MR. BRODER: Since 1996.

20 MR. KOTZ: Okay. And your duties have pretty much
21 stayed the same since then?

22 MR. BRODER: I think they've broadened. I
23 originally was brought in to run the execution desk. And
24 then that was extended into independent risk management. And
25 I'm the executive committee. I'm on the board of directors.

1 So I guess that's (inaudible).

2 MR. KOTZ: Okay. And so when did you first hear of
3 Bernard Madoff?

4 MR. BRODER: Probably when we invested in him.

5 MR. KOTZ: Okay.

6 MR. BRODER: I mean, I would have heard about him.

7 MR. KOTZ: Okay. And so when you had -- when you
8 invested in him, what did you learn about Madoff at that
9 point?

10 MR. BRODER: Well, we invested through Meritage,
11 and you probably know about Meritage. And I guess what was
12 striking at the time was how difficult it was to invest with
13 Madoff. It wasn't like he knocked on the door and said, I
14 want to give you money. It was all, well, I'll think about
15 it. I have to do this. It seemed a very personal process.
16 And in fact, we couldn't invest directly that I remember. We
17 invested indirectly.

18 MS. STEIBER: How?

19 MS. PORTER: Through a swap. Bernie didn't want
20 Renaissance as an investor. Shall I speculate as to why?

21 MR. KOTZ: Sure.

22 MS. PORTER: All right. And it was our
23 understanding that he didn't want us because we were too
24 smart.

25 MR. KOTZ: Meaning that you would do the due

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1 diligence that was necessary to look into it carefully, or --

2 MS. PORTER: I don't know, you know.

3 MR. KOTZ: Okay.

4 MS. PORTER: I don't want to speculate as to what
5 the meaning was. But he did not want Renaissance
6 Technologies as an investor. So we had a relationship with
7 another fund who was also invested in us, and we were friends
8 with them. And they had an allocation. And so we did a swap
9 with them on a portion of their investment in Madoff, which
10 is where the HCH comes from. You know, HCH is the swap
11 counter party.

12 MR. KOTZ: Okay.

13 MS. PORTER: So (inaudible).

14 MR. BRODER: And early on back then with Meritage,
15 a lot of due diligence was done in cooperation with
16 (inaudible). We used to co-invest in various hedge fund
17 managers and things so that, you know, the due diligence
18 issue was shared and discussed and everything else.

19 And it was difficult for them also to do due
20 diligence with -- against Madoff, you know. There's a
21 certain sensitivity to questions and kind of things. But
22 this guy was, you know, a big reputation, longstanding. They
23 didn't want to upset -- you didn't walk in to a guy and say,
24 are you really telling us the truth?

25 So they had to -- and I suspect many people did the

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1 same -- treat him with kind of kid gloves because of that.

2 MR. KOTZ: And there was some sort of exclusivity
3 to his trading.

4 MR. BRODER: Correct.

5 MR. KOTZ: And so that gave what impression to you?
6 What did you make of that?

7 MR. BRODER: Well, that didn't necessarily arouse
8 any suspicion that (inaudible).

9 MR. KOTZ: Okay. Okay. Just that point?

10 MR. BRODER: Yeah.

11 MR. KOTZ: Okay. All right. And were there any
12 whispers out there about Madoff?

13 MR. BRODER: Not that I recall, and I recall pretty
14 good. At that time, no.

15 MR. KOTZ: Okay. Okay.

16 MR. BRODER: So, you know, none that reached me.

17 MR. KOTZ: Okay. But there was a sense that he had
18 very good returns.

19 MR. BRODER: Correct.

20 MR. KOTZ: Okay. And that's why you were
21 interested in getting involved.

22 MR. BRODER: Right. And we later became
23 concerned -- you know, you look at the due diligence and you
24 look at history of the returns just like you do whenever
25 you're going to a new manager. Okay. This guy's had a good

1 track record.

2 And then when you're in the investment for a while
3 and you see what's going on in the marketplace, and you have
4 various currencies going on and various things, and this guy
5 just -- every month, it's more or less a positive number, and
6 it's roughly similar to prior month number. An insignificant
7 amount of variation.

8 Then that is how originally we (inaudible). And I
9 remember, I guess, others, but I remember being suspicious
10 because of that. I mean, nobody is that good unless they
11 have a kind of a technology, a particular technology like we
12 have. And, you know, why we've been that good, we may just
13 have been lucky.

14 So now you look at some of the others. So
15 (inaudible) seems to be as lucky. It didn't seem likely.
16 And that's, I think, why more work was done.

17 MR. KOTZ: Okay. All right. So initially it was
18 based on the fact that he was steady.

19 MR. BRODER: Correct.

20 MR. KOTZ: No matter what happened in the market,
21 no matter what crisis there was, he was almost exactly the
22 same.

23 MR. BRODER: Correct. In my mind, that was signal
24 No. 1.

25 MS. STEIBER: So you thought, even with his stated

1 investment strategy, he should have more correlation with
2 (inaudible) market?

3 MR. BRODER: He should have more volatility. He
4 should have more volatility in his returns than he actually
5 stated. Now, at that time we did think we may be missing
6 something. As we talked later on, could still be -- could
7 still have been -- you know, some sort of could still have
8 been a reasonable conclusion.

9 MR. KOTZ: But that was enough, that particular
10 issue was enough, to look more closely?

11 MR. BRODER: Yeah. And there was two parts to
12 that. I mean, one part was, hey, are these really true? And
13 the other part was, hey, if they really are true, could we
14 learn something about what this guy does?

15 MR. KOTZ: Okay. And so what was the part about
16 "is this really true"? What do you mean by that?

17 MR. BRODER: Oh, because it was too steady. It was
18 just too steady. Either he had a fantastic system -- now,
19 remember at that time he had a fantastic system but he didn't
20 charge anybody any fees. That seemed a little bit strange.

21 MR. KOTZ: Okay.

22 MR. BRODER: Perhaps he's a generous guy.

23 MR. KOTZ: All right. So --

24 MR. BRODER: So, I mean, it was typical of that
25 time, you know.

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1 MR. KOTZ: Right.

2 MR. BRODER: A lot of his friends were in. A lot
3 of the charities were in.

4 MR. KOTZ: Right.

5 MR. BRODER: Maybe this guy really was altruistic
6 and he was just doing this for community investment
7 (inaudible).

8 MR. KOTZ: Do you know of anyone else who
9 (inaudible)?

10 MR. BRODER: No. But there's always exceptions.

11 MR. KOTZ: Right. And so when you say it could
12 have been a great system or, what was the other possibility?

13 MR. BRODER: I think the other possibility is that
14 if we have no evidence -- I'm talking -- I'm trying to put my
15 mind back to then right now (inaudible).

16 MR. KOTZ: Right. Right.

17 MR. BRODER: If we have no evidence of a great
18 system, then it's just something we don't believe in without
19 necessarily -- without necessarily thinking it was fraud. I
20 mean, there was -- and you might remember, Carla -- there was
21 another investment we made around about that time, and it was
22 almost a similar (inaudible), in some sense.

23 It was two brothers, a family investment. It was
24 just two brothers, and they had very steady returns. Because
25 the other thing about steady returns sometimes is you can

1 just be selling options.

2 If you sell way, way out-of-the-money options and
3 you don't mark them for market, then you're just getting a
4 premium in every month you sell them and get (inaudible).
5 And eventually, you know, once every hundred years, the whole
6 blows up and you lose everything.

7 So that was another possibility that we thought of
8 before -- before we got data on Madoff, before we got, you
9 know, (inaudible) data on what he's doing. And there was
10 another strategy like that, and it was just (inaudible).

11 MS. PORTER: Was it (inaudible)?

12 MR. BRODER: No. No, no, it wasn't (inaudible).
13 It was another. It wasn't even --

14 MS. PORTER: I don't remember.

15 MR. BRODER: It was a small operation. And I think
16 we were in them for about a year or so, and we got out of
17 that one for similar concerns. It's too steady, you know.
18 What are they doing?

19 Maybe -- in that case, maybe the concerns were a
20 little more targeted. Are they just selling options? And --
21 but we didn't know at that point. And they actually went
22 bust eventually. They did blow up.

23 MS. STEIBER: Did you think he was possibly just
24 smoothing his returns and giving false statements? Or did
25 you think that the returns were real? Or you didn't know?

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1 MR. BRODER: That's a good question. At that
2 point -- at that point, because I'm still very early on in --
3 we didn't know. I mean, it's well-known that managers do
4 smooth their returns. But I think the fact -- even at that
5 point, we knew what instruments he was trading. So smooth
6 returns didn't seem very likely.

7 You know, we weren't jumping to the fraudulent
8 conclusion at that point. Normally, smoothing makes sense.
9 It means you have a bunch of what we call right now level 3
10 assets, right, in the sense that you're choosing where you're
11 marking them to market.

12 Or, you know, we've made some good gains there.
13 Let's not realize those. And the next month, you have a bad
14 month elsewhere and you decide you'll just realize a few of
15 those gains.

16 MR. KOTZ: Right.

17 MR. BRODER: And it all looks -- we didn't think he
18 was doing anything like that.

19 MR. KOTZ: Okay. So then, because of that, you
20 delved deeper into it?

21 MR. BRODER: Correct. Research work was done. You
22 know, we had access to statements. We had access to both --
23 two sets of statements.

24 MR. KOTZ: Okay. What were those?

25 MR. BRODER: Khronos statements and Samsung

1 Foundation statements.

2 MR. KOTZ: Where did you get those statements from?

3 MR. BRODER: One from the family, family foundation
4 (inaudible). And one from Khronos because they were -- you
5 know, they were only -- they were direct investors.

6 MR. KOTZ: Okay. But you didn't get anything from
7 Madoff. Is that right?

8 MR. BRODER: No. Because we weren't direct
9 investors.

10 MR. KOTZ: So you didn't communicate with Madoff at
11 all?

12 MR. BRODER: No.

13 MR. KOTZ: Okay. So you got these statements and
14 you looked at the statements. What kind of analysis did you
15 do on the statements?

16 MR. BRODER: So the analysis that was done -- as
17 far as I remember, the analysis that was done was things
18 like, for example, you know, remember, this was a managed
19 account. So the statements included every transaction that
20 was done for your account.

21 And as far as I remember, the transactions done in
22 both accounts were very similar, if not almost exactly the
23 same. (Inaudible.) And so you could see all the stock
24 executions, the prices at which those executions -- you could
25 even see the time they were executed, account by account -- I

1 remember for sure about that -- and the options that were
2 executed.

3 This turned out to be a strategy of buying a basket
4 of stocks and then selling -- (inaudible) buying them from
5 (inaudible) any options, any OAX (phonetic) options.

6 MR. KOTZ: Right.

7 MR. BRODER: So we could check various things out
8 about that. I mean, you know, various things came to light,
9 as I -- as I remember, not that well, but I remember, for
10 example, the fills looked very good. But he was a guy who
11 went into the marketplace, and when you compared the fills
12 that he got compared to the closing price, every time he did
13 this over many months of data, it always looked like a pretty
14 good fill.

15 That's pretty hard to achieve. You know, you'd
16 expect it to be approximately random. If you just decide --
17 you personally decide to buy some stocks every -- you know,
18 once a month and then you looked how you did against closing
19 price, you'd be -- some would be worse than the closing price
20 and some would be better. And on average, these were much
21 better than the closing price.

22 Now, maybe he had a prediction. You know, we have
23 predictions for stocks. So I have to tell you, that
24 prediction he would have to have would be much better than
25 our prediction. But we don't have, you know -- you know,

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1 we're pretty -- we don't have that kind of quality of
2 prediction.

3 MR. KOTZ: Would it be much better than any
4 prediction you've seen?

5 MR. BRODER: Yes. Actually, that was one of the
6 best predictions around, that he's much better. But the
7 reason -- I'm digressing a little bit. The reason why our
8 prediction was (inaudible) is because we don't trade once a
9 month. We trade thousands and thousands and thousands and
10 thousands of times.

11 MR. KOTZ: Right.

12 MR. BRODER: So if I'm only right 53 times and
13 wrong 47 times, I'm going to make some money. But Madoff
14 wasn't doing that. You know, once a month or so, he was
15 coming in with this basket of stocks.

16 MR. KOTZ: Right. So he would have to be right.
17 pretty close to 100 percent of the time?

18 MR. BRODER: More or less. I can't remember the
19 exact percentage, but way --

20 MR. KOTZ: A very, very high percentage?

21 MR. BRODER: Very high percentage. Right.

22 MR. KOTZ: And that's something that you had not
23 seen before, and didn't think was possible?

24 MR. BRODER: Well, I knew it wasn't possible
25 because of what we do.

1 MR. KOTZ: Okay. Right.

2 MR. BRODER: But I had not any before because I
3 don't think any -- in the history of America, that I
4 remember, there may be only one or two managed accounts.
5 Most of the time you give the manager your money, he sends
6 you your results. That's it.

7 MR. KOTZ: But from the fact that, you know, you
8 were doing your own productions, you knew that that was not
9 possible?

10 MR. BRODER: Very unlikely.

11 MR. KOTZ: Very unlikely? Okay.

12 MR. BRODER: Right. Very unlikely. So that
13 (inaudible). Now, once that happened, we started asking
14 questions. Well, I remember thinking at the time -- I don't
15 know whether I wrote it down anywhere, and if I did, I'm sure
16 you have it -- whether there was some -- I think I used the
17 phrase, the term, nonperformance-affected counter party. I
18 was thinking of something like a mutual fund.

19 You know, mutual funds are paid by size of assets.
20 They're not really paid by performance. I mean, they can't
21 lose too much money; otherwise they lose the assets. But,
22 you know, if they're still being made -- if you had a blowout
23 year and make 26 percent from a mutual fund when the rest of
24 them are making 18, they don't benefit too much from that.

25 And so I was thinking, well, maybe they do some

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1 basket trades with somebody else and they get more commission
2 and (inaudible). So I wondered where that was going on. But
3 it seemed too regular. You know, (inaudible) again every
4 month some mutual fund comes in and sells in this basket,
5 slightly below the market so it looks better. It didn't
6 quite seem likely.

7 So that was one of the things we looked at, the
8 execution of stocks. The other thing we looked at was the
9 execution of the options. And in particular, I can't
10 remember anything about the quality or the price of the
11 execution of the options. But I can remember particularly
12 the volume of the options.

13 So it told you the strike price. And at that time,
14 we didn't know for sure how much Madoff was managing. We had
15 various estimates, and I think the range was somewhere
16 between 5- and \$15 billion. I can't remember what number we
17 used, but we used a variety of numbers, and then we looked
18 up, well, how many options does that imply in the OAX market?

19 And then I made some assumptions about the
20 distribution of the volume between the strikes in the market,
21 and then how much volume -- and I think I recall that his
22 strikes were all the same. They were the same across the two
23 accounts. So then we just assumed it was the same across all
24 accounts.

25 So could he possibly be doing that volume --

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1 MR. KOTZ: Right.

2 MR. BRODER: -- given the volume of the
3 marketplace? Now, the other curious thing there was that the
4 strike he chose on the day he did it was always close, very
5 close, with a near strike to where the market closed on that
6 day.

7 MR. KOTZ: Right.

8 MR. BRODER: Now, again, unless he had this
9 incredible prediction earlier in the day that he knew where
10 the market was going to close --

11 MR. KOTZ: Right.

12 MR. BRODER: -- he must be doing all those options
13 fairly close to the close.

14 MS. STEIBER: Could you explain that? I don't
15 completely follow that, why it would have to be close to the
16 close.

17 MR. BRODER: Well, let's suppose that -- so let's
18 accept the fact that it was always close to the close, right,
19 which is empirically verifiable. You see the strikes and you
20 see (inaudible). Now let's suppose that you were running
21 something and you said, okay, I'm going to try to be close to
22 the close but I'm going to execute these trades at 10:00 in
23 the morning.

24 Well, you would have no idea where the market was
25 going to go between 10:00 and the end of the day, so

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1 presumably sometimes you would get it wrong. You know, you'd
2 actually keep close to where the market was at that point,
3 and the market would go down a lot, so by the end of the day,
4 your strikes would be nowhere near the close, and vice versa.
5 The market could move away.

6 So it could only be them at the close, right at the
7 close; or, potentially -- well, if he was doing them in the
8 open marketplace, in the OAX -- you know, in the
9 exchange-traded market, he could only be doing them fairly
10 close to the close to ensure that the option strike was close
11 to (inaudible). Otherwise they would just be various and all
12 around that price.

13 Or he was doing it in the OTC market. He was going
14 to somebody late in the day and saying, I need to execute
15 this trade. Now, that counter party would then have to do
16 these options, take on the exposure.

17 I don't know whether he was -- there was no
18 evidence that Madoff was doing a basket with him, a basket of
19 stocks. I assume you know options. Right? You have a
20 (inaudible), and primary risk is a (inaudible) of the option.
21 You know, he could be doing the offsetting basket with the
22 counter party, but there's no evidence on the statement that
23 he was doing that. He was just doing the options.

24 So now here's the counter party. The OTC counter
25 party is taking on this huge 5- to \$10 billion options

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1 exposure, and where are you laying it off? So the market's
2 almost -- you know, it's close to the end of the day and
3 you're laying it off in the OAX market because otherwise
4 you'd see it in the volume. However, where we saw some
5 increase in volume, we didn't see anywhere near the amount of
6 volume spikes to justify what was showing on his statements.

7 MR. KOTZ: So there was no understanding why the
8 counter party would take that kind of risk?

9 MR. BRODER: Correct. So to go back to one of your
10 earlier statements, you know, if you are looking at what
11 would have been nice for me to pick up a phone and say,
12 hello, this is Paul Broder, SEC Commissioner, Bernie. Can
13 you just tell me who you did those trades with so I can call
14 him in the morning and find out what he really did.

15 MR. KOTZ: Right. Right. So what would happen
16 then?

17 MR. BRODER: If I'd asked him that question?

18 MR. KOTZ: Yeah.

19 MR. BRODER: Who knows.

20 MR. KOTZ: Right. But I mean --

21 MR. BRODER: I never asked him that question.

22 MR. KOTZ: -- by simply asking that question and
23 getting the information, you would be able to verify whether
24 this was real or not?

25 MR. BRODER: Well, he may have -- he may in that

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1 situation have given me an answer which wasn't clear. I
2 guess I could have kept pressing him if I didn't (inaudible).

3 MR. KOTZ: Right. Right.

4 MR. BRODER: But, you know, one of the things, I'd
5 say, oh, you did it with Goldman Sachs? Who are the people
6 you speak to at Goldman Sachs?

7 MR. KOTZ: Right.

8 MR. BRODER: Now, this is different from an audit.
9 I used to work for an auditor, and one of the things we'd
10 audit, of course, you'd take all these statements. And once
11 (inaudible) this is a waste of time because he does fraud
12 because you can never speak to the people on either side, you
13 know, get these trades and check them, look at the cash flow,
14 and whatever.

15 MR. KOTZ: Right.

16 MR. BRODER: But here, if he said, I did them with
17 Goldman Sachs, you can pick up the phone with Goldman Sachs.
18 Because the SEC, presumably you can call Goldman Sachs and
19 say, hey, on this date Bernie Madoff said he did this trade
20 with you. Didn't do that.

21 MR. KOTZ: And then you could verify what he said.

22 MR. BRODER: You could verify what he said.

23 MR. KOTZ: Okay. And what if he said he was
24 trading in Europe?

25 MR. BRODER: Well, I guess you haven't got the

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1 enforcement capability there, although it would have to --
2 again, it would have to be with -- he would have to be, in my
3 mind, with a non-American firm who had no American
4 operations.

5 MR. KOTZ: Right.

6 MR. BRODER: Because if you people (inaudible) --

7 MR. KOTZ: Right.

8 MR. BRODER: -- they're going to be on -- they're
9 going to answer whatever questions you're asking. Right?

10 MR. KOTZ: And so if you were in the -- if you were
11 a regulator and you had these concerns, and Bernie Madoff
12 said, I'm trading in Europe, would you just let it go at
13 that? Or would you follow up in some way or another, whether
14 you had the jurisdiction or not, to see if it was really
15 true?

16 MR. BRODER: Yeah. I didn't see why it would
17 make -- I mean, I don't know how the SEC operates, but I
18 don't see why it would make any difference.

19 MR. KOTZ: Right.

20 MR. BRODER: I mean, again, unless it was a
21 non-American institution who had no branches here at all, I
22 don't know, Berliner Bank or something --

23 MR. KOTZ: Take away the issue of whether the SEC
24 has the ability to, in terms of just coming with a concern,
25 expressing it to Bernie Madoff, and he comes back and saying,

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1 I'm trading in Europe. Wouldn't you take some action --

2 MR. BRODER: Yes.

3 MR. KOTZ: -- to find out whether that was true or
4 not?

5 MR. BRODER: Yes. I don't see why it would make
6 any (inaudible).

7 MR. KOTZ: Right. And that simple action would
8 reveal whether he was telling the truth. Right?

9 MR. BRODER: Yes. I mean, for us, you know, there
10 was a certain amount of capital, which implied a certain
11 level of trading. And that volume of trading had to go
12 somewhere.

13 MR. KOTZ: Right.

14 MR. BRODER: Now, one of the things, you look at
15 the statements, it wasn't clear -- well, actually, I'm not
16 actually -- I want to say something, and I'm not even sure on
17 a legal basis I'm going to say -- but I'm not even sure, and
18 you (inaudible).

19 When you get a managed account statement, I
20 remember thinking at one point that managed account is
21 showing me my trades -- assume I'm the investor -- my trades
22 with Madoff, or is he showing the trades in my account with
23 whoever he dealt with?

24 MS. PORTER: The trades in your account that he
25 brokered on your behalf.

Page 25

1 MR. BRODER: Right. Right.

2 MS. PORTER: So -- okay?

3 MR. BRODER: Okay. So therefore, somewhere in
4 the -- somewhere in the marketplace, either in an
5 exchange-traded marketplace or an OTC marketplace, exactly
6 those trades which were on that client account statement
7 should exist on someone else's books, you know.

8 And the other thing that crossed our minds at one
9 point was, well, if we knew he had this market-making
10 operation so, you know, with our counter party somehow, that
11 market-making operation and -- but I think we dismissed that
12 in the end as regards -- you know, market-making is
13 competitive.

14 So there's not some soft income source he would be
15 siphoning off there to (inaudible). His market-making side
16 wouldn't make any money. So we kind of explored that avenue
17 and kind of dismissed it in the end.

18 To go back to your question, yes. Somewhere in the
19 marketplace, either OTC or exchange-traded, those trades were
20 taking place. And it seems to me a very simple set of steps
21 to verify that those volumes (inaudible).

22 MR. KOTZ: And now, with hindsight from what we
23 learned in December, do you think that that would have
24 brought to your attention that there was no trading?

25 MR. BRODER: I don't see how that would have been.

1 missed in a situation (inaudible).

2 MS. STEIBER: Speak up a little bit.

3 MR. BRODER: I don't see how that could have
4 possibly been missed. I mean, this is a very simple
5 verification. I mean this guy is trading -- this is a cash
6 account. So he's turning over \$10 billion off stocks each
7 particular month. I mean, you've got to be (inaudible) in
8 the marketplace.

9 MS. STEIBER: Where would you have looked?

10 MR. BRODER: Well, I would ask -- I would ask
11 Bernie Madoff. I would have said, who are the -- where are
12 you doing these trades? Let's think of stock trades. Who
13 are you doing these trades with? And, you know, is it
14 Ireland? Is it -- you know, is it New York Stock Exchange?
15 Is it OTC with Merrill Lynch? And then you would have just
16 gone out and verified those trades actually existed.

17 MS. STEIBER: Would you have been skeptical if he
18 said he traded over the counter? Because isn't
19 over-the-counter trading more expensive than trading on an
20 exchange? You know, cut into your profits?

21 MR. BRODER: It could be, but not necessarily.
22 There may be -- if you're doing a block trade -- I mean, even
23 now, you know, if some large insurance company wants to do a
24 block trade, there's two ways of doing it -- well, there's
25 two ways of doing it.

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1 Certainly you could put it out on the New York
2 Stock Exchange or you could just keep selling, selling,
3 selling. Or you could call Goldman Sachs and say, hey, make
4 me a deal on \$2 million of this stock and I'll make you a
5 bid. And then it's off your books, and you don't even write
6 your ticket. And you don't even have to worry about the
7 (inaudible).

8 Lots of nice people do that these days. But it's
9 changing fast, and three or four years ago, it was much more
10 prevalent to do that. So it wouldn't necessarily arouse my
11 suspicions if he'd said, no, I'm doing them OTC. But it
12 would have been a lot easier to check, you know. Oh, I
13 bought \$30 million of, you know, Exxon with Goldman Sachs,
14 you know. You would have only had to check one trade.

15 MR. KOTZ: Right. Correct.

16 MR. BRODER: Because as it turned out, you wouldn't
17 know that then, but if you'd just check one trade, you
18 wouldn't have found it because he didn't do any trades.

19 MR. KOTZ: So in some ways there are a couple
20 possibilities of what he could have been doing --
21 front-running or, as it turns out, a Ponzi scheme. Isn't it
22 fair to say that the Ponzi scheme would have been easier to
23 verify?

24 MR. BRODER: I don't think you could have said that
25 then. But if you'd read the e-mails --

1 MR. KOTZ: Right.

2 MR. BRODER: -- which I guess we'll get into, you
3 would have thought the question would come to mind, hey,
4 these guys are debating whether he could possibly be doing
5 this volume. Let's -- the next step will be let's try to
6 verify that he did this volume.

7 MR. KOTZ: Right.

8 MR. BRODER: And the first time you checked a
9 trade, you would have found it's not there.

10 MR. KOTZ: Right. So the first thing you might
11 have gone to from these e-mails would be to look if there was
12 actually volume and the trades. And then, as we know now, if
13 you had done that, you would have seen no trades.

14 MR. BRODER: I think so.

15 MR. KOTZ: Do you want to talk a little bit about
16 some of the specifics of the e-mail? And then maybe we can
17 ask you about --

18 MR. BRODER: This?

19 MS. PORTER: You have the --

20 MR. KOTZ: Yeah. The April 20, 2004, 2:12 p.m.

21 MS. PORTER: I don't have it. Maybe Frank does. I
22 mean, I have the -- it would be good if you were looking at
23 the same page.

24 MS. STEIBER: Yeah. It's the 20th.

25 MS. PORTER: Yeah. But you took it back after

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1 Henry looked at it. There you go. You know, you're saying
2 it -- I'm sorry. Your versions say April 20th. Remember,
3 that's when it went to the (inaudible).

4 MR. BARRON: Right. That's an internal.

5 MS. PORTER: So to us, that means nothing. So we
6 have to actually look at the --

7 MR. BRODER: Neither of these are my e-mails.
8 Right?

9 MR. KOTZ: Right. Right. We have another one that
10 is yours. But just to get your kind of general thoughts on
11 some of the things that are mentioned in this e-mail, if you
12 see the first one, which I think is from Nat Simons --

13 MR. BRODER: Right.

14 MR. KOTZ: -- he talks about, "Been to an ex-Madoff
15 trader. He says that Madoff cherry-picks trades and takes
16 them for the hedge funds. He said Madoff is pretty
17 tight-lipped and therefore he didn't know much about it, but
18 he really didn't know how they made money. David Zierk heard
19 a similar story."

20 So were you getting several accounts of other
21 people raising concerns at that time, do you remember?

22 MR. BRODER: I can't remember when this came in
23 relation to the research and everything else.

24 MR. KOTZ: Okay.

25 MR. BRODER: I remember reading this. As it turned

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1 out, of course, this was not true. Right? Because he can't
2 have been cherry-picking because he wasn't doing any trades
3 at all.

4 MR. KOTZ: Right. Right. But there were a couple
5 of ex-Madoff traders that seemed to have some concerns about
6 what he was doing.

7 MR. BRODER: Right. Right.

8 MR. KOTZ: And then what about this issue of, "Why
9 does he let us make so much money? Why doesn't he capture
10 that for himself?"

11 MR. BRODER: Right. Well, that's what I alluded to
12 earlier in the conversation about if he had such a great
13 predictive system, why was he not keeping more of it to
14 himself? He wasn't charging any fees. It was thought that
15 he was making money on the flow of trades as they went
16 through.

17 But, you know, normally when you make money on the
18 flow of trades, the client loses money on the other side.
19 Right? You know, (inaudible) at 19, you pay him 18 kind of
20 thing.

21 MR. KOTZ: Right.

22 MR. BRODER: But here he seemed to be getting a
23 great fill every time he executes for the client.

24 MR. KOTZ: Right.

25 MR. BRODER: So it was little bit suspicious how

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1 he -- how he was making that money. Then we said, well,
2 maybe he's charging commission.

3 MR. KOTZ: Yeah. So then given the volume that you
4 were talking about, there was a tremendous amount of money
5 that he wasn't charging.

6 MR. BRODER: Correct. But also, potentially it
7 (inaudible) on commission, but actually it was back to
8 whether you believed that idea of, you know, Bernie Madoff
9 the philanthropist, you know, allowing everyone else to make
10 money on him, just passing it --

11 MR. KOTZ: Right.

12 MR. BRODER: You know, had to (inaudible) an
13 exception.

14 MR. KOTZ: Was that something that, you know, was
15 believable?

16 MR. BRODER: If you're asking me -- let's suppose
17 there was a predictive system in some way that he could make
18 money, and the only money he was choosing to take was the
19 commission on the trades. I didn't find that completely
20 unbelievable at the time.

21 MR. KOTZ: Okay.

22 MR. BRODER: I mean, for some reason, he's got so
23 much money he doesn't want to (inaudible).

24 MR. KOTZ: But it was suspicious?

25 MR. BRODER: It was suspicious.

1 MR. KOTZ: Okay. And then this issue later, where
2 you talk about -- not you, but I guess Nat, talks about that
3 you saw about the conflict and learning that his
4 brother-in-law is his auditor, what did you make of that?

5 MR. BRODER: (Inaudible.) I have no idea
6 (inaudible). Yeah. So I don't understand the question. No,
7 I actually do. The sentence where -- oh, his brother-in-law.
8 (Inaudible) that his brother-in-law is his auditor, and he's
9 also high up in the organization.

10 MR. KOTZ: Okay. What is he getting at there?

11 MR. BRODER: When he said he was (inaudible) that?

12 MS. PORTER: No. The brother-in-law.

13 MR. KOTZ: Well, what would be the effect of that?
14 What was the concern or --

15 MR. BARRON: About the brother-in-law, you mean?

16 MR. KOTZ: Yeah. Just about the operation, the
17 conflict and the fact that it's a family situation, and that
18 there's a relative as his auditor. What would that mean to
19 you?

20 MR. BRODER: Well, that just means the auditor is
21 not independent, or there's some potential influence there.

22 MS. STEIBER: So why would that be a concern?

23 MR. BRODER: Well, you know, when we go into a
24 hedge fund and we invest and we find that, you know, PW are
25 the auditors, then that brings a small degree of comfort that

1 there's some independent -- I am expecting auditors
2 generally, since I was once one -- you know, it gives you
3 some faith that, you know, there's some independent look
4 there.

5 But if the guy who's supposed to be independent is
6 actually his brother-in-law then, you know, that's not so
7 good.

8 MR. KOTZ: Doesn't give you much faith?

9 MR. BRODER: It gives you less faith.

10 MR. KOTZ: Less faith. But from a regulator's
11 perspective, wouldn't that be something that would raise a
12 big red flag for a regulator?

13 MR. BRODER: I would have thought our due diligence
14 process, the larger the -- you know, if it turned out there
15 was a \$20 million hedge fund in the brother-in-law, then the
16 SEC (inaudible). But when it gets to 5-, \$10 billion, you
17 would think you'd want to see more than -- wasn't this a
18 one-man operation, too, this auditor? One guy?

19 MR. BARRON: Might have been three.

20 MS. STEIBER: Yeah. What about --

21 MR. BRODER: Yeah. So it wasn't a lot.

22 MS. STEIBER: What about custody of assets? Is
23 that something you look at in your -- in your due diligence
24 process? Not to get too far away, but --

25 MR. BRODER: Where are there -- (examining).

1 MS. STEIBER: Do you usually want them held by a
2 third party?

3 MR. BRODER: You know, you would have to ask them
4 that. I don't --

5 MS. PORTER: Remember --

6 MR. BRODER: I don't know all the legal
7 (inaudible). But I just -- I'm no longer involved in that
8 part of the business. And back then, I can't remember --
9 yeah, that must have come up, but I can't remember. In this
10 context, he did his own custody because he had his own
11 market-making operation.

12 But in your question, you're obviously getting to,
13 you know, was that a red flag also because you hope that it
14 was done elsewhere. Yeah, I guess most of the people that we
15 invest in have -- you know, they use Goldman or they use
16 Morgan or they use somebody. But he was doing it himself.

17 Yeah, it's a good point. I can't remember -- I
18 can't remember whether we missed that, but it is a good
19 point.

20 MR. KOTZ: Okay. And so what -- did you come to
21 kind of any conclusion or did you just know enough to have
22 concerns?

23 MR. BRODER: I think if you're asking did we come
24 to the conclusion that there was a fraud going on, I would
25 say we didn't. I would say we came to the conclusion --

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1 well, there was a committee, so I'll speak for myself.

2 I came to the conclusion that we didn't understand
3 what he was doing. We had no idea how he was making his
4 money. The numbers, the volume numbers that he suggested he
5 was doing was not supported by any evidence we could find.
6 And, you know, that in itself should just mean we get out.

7 MR. KOTZ: Right. And so is it fair to say that
8 there was at least the possibility of fraud? I mean, there's
9 a reference in that e-mail to, "Madoff's head looked pretty
10 good above Eliot Spitzer's mantle."

11 MR. BRODER: Oh, yeah. I think I wouldn't put too
12 much weight on that. I think Spitzer was going around -- who
13 was he going after at that time? He wasn't after Madoff, but
14 he was going after somebody. Oh, he was going after --
15 wasn't it Greenberg? Isn't that (inaudible) in Greenberg?

16 MR. KOTZ: Right. Right.

17 MR. BRODER: I'm trying to remember back then what
18 I thought. Did I think this guy was fraudulent? I don't
19 think so. I mean, if somebody had asked me then, could this
20 guy be fraudulent, I couldn't have answered no. Right? But
21 I didn't think -- of course, if I could have asked Madoff
22 myself, you know, looked at his statements and looked at
23 counter parties, then that would be different.

24 But, you know, we couldn't do that, and I don't --
25 it was more or less just an investment decision. Given what

1 we know, should we stay in this investment? And I thought we
2 should not.

3 MR. KOTZ: Okay. Were you aware at the time that
4 the SEC had looked at Madoff?

5 MR. BRODER: No. I was not. I don't know
6 (inaudible).

7 MR. KOTZ: Okay. If we could move to the other
8 e-mail because this is yours. And just take a look at that
9 and see if there's anything in there that we haven't kind of
10 covered, or maybe just give us a little bit of an explanation
11 of --

12 MS. PORTER: Could I ask you one thing? I've just
13 been asked to ask you if by any chance you'd be willing to
14 take a lunch break at 1:00 for a couple of hours because
15 there's an executive committee meeting scheduled at 1:00. We
16 thought we'd be done by then, and we're not.

17 MR. KOTZ: Okay.

18 MS. PORTER: So I've been asked by -- to relay this
19 message and request to you by Jim Simons, who would be
20 appreciative if they could keep on schedule with their 1:00.

21 MR. BRODER: We're going to finish mine soon?

22 MS. PORTER: We would finish you. But then we
23 wouldn't have gotten to Nat.

24 MR. KOTZ: Okay. Yeah, I think what we can do is
25 we --

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1 MS. PORTER: Can you take a break for an hour and a
2 half or two?

3 MR. KOTZ: Yeah. We have somebody at 2:00, but
4 that probably won't be long. So maybe we can come back at
5 that time. We can come back.

6 MS. STEIBER: And we could get Nat then.

7 MR. KOTZ: Maybe at like 3:00 -- 2:30?

8 MS. STEIBER: 2:30 or 3:00. Maybe he could come
9 earlier.

10 MS. PORTER: That would be --

11 MR. KOTZ: Maybe at -- yeah. What about 3:00?

12 MS. PORTER: That would be terrific.

13 MR. BRODER: So let me go through this. So --

14 (End of tape.)

15 MR. KOTZ: So just to kind of clarify the point
16 because we want to make sure that we got it is that from your
17 e-mail, you had concluded that Madoff couldn't have been
18 trading over the counter.

19 And if you were a regulator and you saw that and
20 Bernie Madoff represented to you that he was trading over the
21 counter, you would be very suspects about that and make sure
22 to follow up because it would seem that that couldn't be
23 true. Is that fair?

24 MR. BRODER: Correct. I would certainly ask who
25 that counter party was, and then verify, you know

1 (inaudible).

2 MR. KOTZ: And given what you found and the
3 information in the e-mail, you wouldn't accept simply that
4 Madoff said he traded over the counter because from the
5 information in the e-mail, it seems that that wasn't the
6 case.

7 MR. BRODER: Correct.

8 MS. STEIBER: And did you get anyone to follow it
9 up with you from the SEC?

10 MR. BRODER: No, they did not.

11 MR. KOTZ: Okay. So nobody asked you any
12 questions, asked for any more information to get any more
13 analysis about the e-mail?

14 MR. BRODER: No, they did not.

15 MR. KOTZ: Okay. All right. Thank you for your
16 time. We appreciate it very much.

17 (Whereupon, the interview was concluded.)

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RECEIVED

Testimony of Laufer

Page 1

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-509
OIG-509)

PAGES: 1 through 53
PLACE: Renaissance Technologies Corporation
 800 Third Avenue, No. 34
 New York, New York 10022
DATE: Thursday, March 12, 2009

The above-entitled matter came on for hearing, pursuant
to notice, at 11:00 a.m.

TAPE TRANSCRIPTION

Diversified Reporting Services, Inc.

(202) 467-9200

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2

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25

1 PROCEEDINGS

2 MS. STEIBER: This is Heidi Steiber and David Kotz
3 at Renaissance Technologies on May 12, 2009.

4 MS. PORTER: -- on the examination, and she
5 provided the documents as requested to the examiner.

6 MR. KOTZ: Right.

7 MS. PORTER: She kept a file, and so we know what
8 documents -- there are about 4,000 pages of documents that --
9 with what the examiner, you know, departed --

10 MR. KOTZ: Okay.

11 MS. PORTER: -- on a disk.

12 MR. KOTZ: Okay.

13 MS. PORTER: And I have an index to those
14 documents.

15 MR. KOTZ: Okay.

16 MS. PORTER: In addition, she has in her file these
17 Madoff-related e-mails. She has them separate with a little
18 heading on them that says, "SEC 304 RIA Exam." Because they
19 were of particular interest to the examiner --

20 MR. KOTZ: Okay.

21 MS. PORTER: -- she actually kept them apart
22 because he did focus on them. So --

23 MS. STEIBER: Those would be the ones we were
24 interested in, not (inaudible).

25 MS. PORTER: No. But I'm just telling you what --

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1 giving you the whole picture. So I know only from the fact
2 that she kept clipped these particular e-mails that were of
3 interest to the examiner.

4 MR. KOTZ: Great. Great.

5 MS. PORTER: So that's how I know. Actually, one
6 of the e-mails that you cited to me, Heidi, was not in that
7 collection. So I'm not entirely sure how that -- you know,
8 how you have it --

9 MS. STEIBER: Right.

10 MS. PORTER: -- and I don't have it in the little
11 grouping that she clipped as of particular interest to the
12 examiner.

13 MR. KOTZ: Okay. Well, we can sort all that out.

14 MS. PORTER: Right. Yeah.

15 MR. KOTZ: But, I mean, as complete a record as
16 possible that we have would be helpful for us to, you know,
17 kind of make sense of all this.

18 MS. PORTER: Yeah.

19 MR. KOTZ: So we want to get the documents but
20 also, you know, just kind of ask a few questions about what
21 led to the writing of this e-mail and, you know, what was the
22 thinking in mind; and also, you know, whether there was
23 follow-up from the SEC back to your folks to ask further
24 questions to get more information, or whether it was just
25 kind of left.

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1 So I don't know how you want to do this. Do you
2 want to -- can we just start with Henry or --

3 MR. LAUFER: Sure.

4 MS. PORTER: Yeah. I'm sorry at some level that we
5 didn't bring Paul and Nat into this preliminary conversation.
6 I may have to ask you --

7 MR. KOTZ: Okay. Sure.

8 MS. PORTER: -- because, you know, they're -- this
9 is not something that happens in their world every day of the
10 week.

11 MR. KOTZ: Right. Right.

12 MS. PORTER: So I think it would be very helpful
13 for them to hear what you just said.

14 MR. KOTZ: Okay.

15 MS. PORTER: So perhaps later on, if you don't
16 mind, if you would revisit that veteran, it will go a long
17 way to helping them understand the framework of this
18 discussion. So forgive me for asking you to do it again --

19 MR. KOTZ: No, no. Not at all. Not at all.

20 MS. PORTER: -- for asking you to give that speech
21 again later on. Since you did ask to meet them
22 individually --

23 MR. KOTZ: Right.

24 MS. PORTER: -- we didn't have them all here at
25 once, although, who knows, it might actually be beneficial to

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1 have them all at once to converse with. That's (inaudible).

2 MR. KOTZ: Yeah. I mean, I think the only -- the
3 only thing was it would be kind of hard to, you know, get it
4 all down if there's several people talking at once.

5 MS. PORTER: I see.

6 MR. KOTZ: It wasn't anything -- but maybe, you
7 know, we can try, and if there's further thoughts, we can
8 grab everybody back for a few minutes.

9 MS. PORTER: Okay.

10 MR. KOTZ: We could at least bring the other two in
11 when I go over the introduction.

12 MS. PORTER: Then one further thought before you
13 start addressing your questions to Henry. The issues you
14 have that are more general in scope about the SEC and our
15 interaction, how the, if you will, the end user interacts
16 with the SEC --

17 MR. KOTZ: Right.

18 MS. PORTER: -- and all that sort of thing is a
19 discussion I would suggest you would have not with Henry,
20 Nat, or Paul because they don't interface with the SEC.
21 That's not their province.

22 MR. KOTZ: Okay.

23 MS. PORTER: And I don't think they'd be
24 comfortable responding to that kind of question.

25 MR. KOTZ: Sure.

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1 MS. PORTER: On the other hand, that may be
2 something that, off the record without a microphone --

3 MR. KOTZ: Yeah.

4 MS. PORTER: -- we in the legal department --

5 MR. KOTZ: Yeah. No, that would be very
6 (inaudible).

7 MS. PORTER: -- would be happy to -- you know, if
8 you really are trying to understand how the examined party --

9 MR. KOTZ: Right.

10 MS. PORTER: -- interacts with the examiner and
11 what our perspective is on how they conduct an examination, I
12 think if you look at our record at Renaissance, we're
13 extremely cooperative.

14 MR. KOTZ: Right.

15 MS. PORTER: We try very hard to be, you know, on
16 the good side of the SEC at all times. We've gone down there
17 on numerous occasions and tried to help you regulate us and
18 the industry.

19 MR. KOTZ: Right. Right.

20 MS. PORTER: And so I am sure that Mark Silber,
21 who's our chief financial officer and chief compliance
22 officer, and I and our staff would be happy to have that kind
23 of informal dialogue with you --

24 MR. KOTZ: Sure.

25 MS. PORTER: -- and share with you our reactions

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1 and our views --

2 MR. KOTZ: Yeah.

3 MS. PORTER: -- if what you want is a takeaway that
4 could perhaps improve the model. But that's not something
5 that I would ask you to do with --

6 MR. KOTZ: Okay. Sure. Yeah, that would be, yeah,
7 just totally informal and just, you know, having a
8 conversation.

9 MS. PORTER: Thank you.

10 MR. KOTZ: Okay. Why don't we just then start with
11 Henry and get to the specific questions. Let me just first
12 say other than myself and Heidi, Francis Barron is here from
13 Cravath, Swaine & Moore, and Carla Porter, general counsel of
14 Renaissance Technologies. And now I will direct my questions
15 to Henry Laufer.

16 Henry, could you just tell me just very briefly
17 your current position and, you know, your --

18 MR. LAUFER: I'm a scientist at Renaissance.

19 MR. KOTZ: Okay. And how long have you been with
20 Renaissance?

21 MR. LAUFER: Depends how you count. But we tend to
22 say 1991 full-time. I was part-time on and off before that.

23 MR. KOTZ: And you've always been in the same role?

24 MR. LAUFER: No.

25 MR. KOTZ: Okay.

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1 MR. LAUFER: I was various titles. At one point I
2 was vice president for research.

3 MR. KOTZ: Where were you in -- what was your
4 position in 2003?

5 MR. LAUFER: I don't know. Was I chief scientist
6 then? I was one of those -- I was one of those two.

7 MR. KOTZ: Okay. And can you just give me
8 generally what your duties are?

9 MR. LAUFER: Sure. So I helped design the trading
10 systems that we use. It was mostly my title that changed,
11 not what I did. Well, no, I take that back. My
12 responsibility for other people has varied over time.

13 MR. KOTZ: Okay. But in terms of the substantive
14 duties, it's been basically the same?

15 MR. LAUFER: That's right.

16 MR. KOTZ: And so at a certain point you heard of
17 Bernie Madoff. When do you remember you first heard about
18 Bernie Madoff?

19 MR. LAUFER: It could be one of two instances. So
20 Meritage, which is a -- which at that time, when I heard of
21 them, was -- I wouldn't call it a subsidiary of Medallion,
22 but it was closely associated with Medallion -- had an
23 investment in Meritage. I sat on the appropriate committees,
24 and his name came up.

25 There was another time when we were thinking of

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1 doing trading through his brokerage firm, and I met him at
2 that point. ut I can't tell you which one I heard of first.

3 MR. KOTZ: Okay. And so what was your perspective
4 when you met him? I mean, how did --

5 MR. LAUFER: Seemed okay to me. So there was a --
6 not me, not him and I, the two of us -- there was a group
7 meeting.

8 MR. KOTZ: Okay.

9 MR. LAUFER: Seemed reasonable.

10 MR. KOTZ: And were there, you know, whispers about
11 him at any point that you were aware of?

12 MR. LAUFER: Oh, yeah. There were always -- I
13 don't know, I mean, from that time this was my conduit. But
14 he had passed on rumors -- I don't know where he got them --
15 of, you know, that Madoff does very -- you know, his returns
16 are astoundingly good and a lt suspicious in that sense.

17 MR. KOTZ: Okay.

18 MS. STEIBER: About what year are you first hearing
19 whispers from (inaudible) or rumors?

20 MR. LAUFER: I don't remember.

21 MS. STEIBER: Was it in the '90s? Was it in the
22 (inaudible)?

23 MR. LAUFER: I don't remember. It was a long time
24 ago.

25 MR. KOTZ: So it was -- but it was, you know, a

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1 long time. It wasn't in the last three or four years?

2 MR. LAUFER: Oh, no, no.

3 MR. KOTZ: It was years and years ago?

4 MR. LAUFER: A long time ago.

5 MR. KOTZ: Okay. And then you heard -- in
6 connection with the fact that his returns were incredible and
7 suspicious, was there any more in terms of, you know, how he
8 was able to achieve it? What was the rumor about, you know,
9 how he was able to make these -- get these great returns?

10 MR. LAUFER: You really want me to repeat rumors?
11 I mean, these are --

12 MR. KOTZ: Well, I mean, I think it's important for
13 us to have the feeling in the community.

14 MR. LAUFER: This is totally worthless, but I'll
15 tell you what I heard. Okay?

16 MR. KOTZ: Okay.

17 MR. LAUFER: That, you know, because he was a
18 broker dealer, he would see order flow and he would somehow
19 deduce from the order flow that he would see -- this is the
20 good side. The good side is he would see order flow, and
21 from that he could deduce various market forces. And
22 therefore, he could do things.

23 The bad side is he would see order flow and he
24 would front run.

25 MR. KOTZ: Right. Okay.

1 MR. LAUFER: But those are just rumors. I mean,
2 they're totally worthless rumors. I'm sort of embarrassed to
3 even repeat them.

4 MR. KOTZ: Okay. But then at a certain point there
5 was some due diligence done or some review in connection with
6 an investment.

7 MR. LAUFER: That's right. But I was not really
8 part of that.

9 MR. KOTZ: Okay.

10 MR. LAUFER: Well, mainly I was on the -- I was on
11 the committee that heard various things, but I was not --
12 you'll have to ask another question. I don't mean to
13 (inaudible). In other words, yes, there was due diligence
14 somewhere around (inaudible), and yes I was in some sense
15 part of this. But I --

16 MR. KOTZ: Okay. Okay. So when you were -- okay.

17 MR. LAUFER: I was sort of adjunct. (Inaudible)
18 important or not.

19 MR. KOTZ: Yeah.

20 MR. LAUFER: But I really --

21 MR. KOTZ: What do you remember about the due
22 diligence? Just what do you remember about --

23 MR. LAUFER: I'm sort of confused here. There was
24 a report that was referred to, e-mails referred to.

25 MR. KOTZ: Right.

1 MR. LAUFER: If you want me to talk about that, I
2 know. If you want me to talk about due diligence --

3 MR. KOTZ: Sure. Okay. So let's talk about the
4 e-mails.

5 MR. LAUFER: Okay.

6 MR. KOTZ: What was the information that you all
7 had that you were referring to the SEC?

8 MR. LAUFER: Okay. Well, first of all, I didn't
9 refer anything to the SEC. That was done in other parts of
10 Renaissance.

11 MR. KOTZ: Okay.

12 MR. LAUFER: Okay. So we had looked into monthly
13 reports provided to us by friends and Madoff statements of a
14 Madoff managed account, or maybe two Madoff managed accounts.
15 I don't remember exactly. And we were looking at them to try
16 and understand what Madoff was doing, both for seeing whether
17 it was a good idea to have an investment with them or whether
18 we can learn something from his style of trading.

19 So that was done under my supervision. I didn't do
20 all the work, but that was done under my supervision.

21 MR. KOTZ: And do you remember when that occurred?

22 MR. LAUFER: Well, I -- a long time ago. About
23 five years ago, something like that.

24 MS. STEIBER: And who did the work?

25 MR. LAUFER: Mark Rose-Brown (phonetic) and

1 possibly other people. But I remember very much supervising
2 Mark Rose-Brown in this matter.

3 MR. KOTZ: How long of a process did it take?

4 MR. LAUFER: Again, it's a long time ago. I would
5 guess three to six months, would be my guess.

6 MR. KOTZ: So what kind of work was Mark Rose-Brown
7 doing that you were supervising?

8 MR. LAUFER: Well, as I said, we have access to
9 monthly statements from an account. And we had that
10 transcribed, and we were doing what I would call fairly
11 standard analysis, although unfortunately not quite so
12 standard because we hadn't -- we don't do the type of trading
13 that Madoff did. But we were attempting to understand
14 Madoff's trading in the style of -- that we trade.

15 MR. KOTZ: So what kind of steps would you take to
16 try and understand Madoff's trading?

17 MR. LAUFER: Well, first of all, this is -- you
18 transcribe it so that you can look at his profits on a
19 monthly basis. And you see if the -- if you can understand
20 what methods he was using or what style of trading he was
21 doing. Now, it isn't as if you press a button and out comes
22 the summary --

23 MR. KOTZ: Right.

24 MR. LAUFER: -- so you can look at it and -- but
25 his style of trading was what was out in the public domain,

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1 and he would buy on -- I think -- I forget whether it was a
2 monthly or quarterly basis. He would buy a basket, a very
3 ordinary basket of stocks, some very large capital stocks
4 like General Electric and Microsoft.

5 And he would at the same time -- I don't remember
6 whether he bought or sold, but he would create an options
7 portfolio which was very roughly the opposite of the stock
8 portfolio. And presumably he made money by correctly
9 pricing -- in other words, by buying the options portfolio at
10 a good price relative to the price at which he bought the
11 stock portfolio.

12 MR. KOTZ: And did you look into how he seemed to
13 be so good at picking the right price and the right time?

14 MR. LAUFER: Well, in some sense, yes. But we
15 really did not know. That's speculative.

16 MR. KOTZ: Right.

17 MR. LAUFER: We did not know why he was so good at
18 what he did.

19 MR. KOTZ: Okay. Other than the statements you
20 mentioned, did you request any documents? What else did you
21 get? Did you get anything else from Madoff?

22 MR. LAUFER: We got nothing from Madoff. We got --
23 this is all from friends. In other words, Madoff, as I
24 understand it -- and again, this is very old, okay -- so
25 normally speaking, if you have a managed account, you get a

1 monthly brokerage statement.

2 MR. KOTZ: Right.

3 MR. LAUFER: So we had access to monthly brokerage
4 statements, not provided to us by provided by friends. And
5 we looked at the monthly brokerage statements from Madoff,
6 whatever the name of his company was.

7 MR. KOTZ: Right. And --

8 MR. LAUFER: But we didn't contact Madoff directly.

9 MR. KOTZ: Okay. And you didn't look at anything
10 else other than that?

11 MR. LAUFER: Well, of course we have access to our
12 database of prices.

13 MR. KOTZ: Right.

14 MR. LAUFER: So we knew what market prices were
15 involving this information about the items that appeared in
16 the brokerage statements.

17 MR. KOTZ: Right. Okay. But that was the end of
18 it. Okay. And so what did you find during -- or this
19 individual who worked under you, what did he find?

20 MR. LAUFER: Do you want a brief technical summary?

21 MR. KOTZ: Sure.

22 MR. LAUFER: Okay. So this is very old, you know.
23 I wouldn't swear anything I told you was correct.

24 MR. KOTZ: Okay.

25 MR. LAUFER: Okay. So we found -- so there's a

1 stock side on which he purchases stocks.

2 MR. KOTZ: Right.

3 MR. LAUFER: And there's an options side in which
4 he purchases, as I said -- I don't remember if he brought or
5 sold because there's a lot of equivalence. So there's a
6 stock side and there's an option side.

7 And so we found that the stock side, he was able to
8 buy -- so he was buying and selling stocks. He was able to
9 report it that he was buying stocks at -- on any given day,
10 if he bought a stock, he managed to buy it -- or he'd report
11 that he bought it at prices that were very low. And when he
12 sold stocks, he managed to sell stocks, or reported he sold
13 stocks, at prices that were very high.

14 So this was statistically almost impossible to do
15 if you were trading in an ordinary way. In other words, an
16 ordinary way is you wake up in the morning and you decide to
17 buy 10,000 shares of General Electric. And you're going to
18 buy those 10,000 shares -- you're probably going to get --
19 probably going to get them average price. And he managed to
20 report a much more favorable than average price. We had no
21 idea how he did that, although -- yes.

22 So it's all -- on the stock side, he seemed to do
23 very well. And on the options side, he also seemed to do
24 pretty well. We didn't have -- pricing of options is much
25 more difficult, nor am I some expert on that. But the option

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1 price seemed to be okay. He seemed to be -- we had no idea
2 how he did the volumes in options that he reported.

3 Should I continue here?

4 MR. KOTZ: Sure.

5 MR. LAUFER: Okay. So we only have access to one
6 or maybe two accounts, which was small accounts. And it
7 was -- you could certainly do those volumes in those
8 individual accounts, no question about it. And then there
9 were rumors that he was managing billions of dollars. So we
10 didn't know how he managed -- if you assumed that whatever we
11 saw in our accounts, he did the same thing for every other
12 account, we didn't understand how he possibly could do those
13 option trades.

14 MS. STEIBER: Why didn't you understand, based on
15 the size, how he could do it in the two accounts but he
16 couldn't do it in the larger accounts? Could you please
17 explain how size mattered to you?

18 MR. LAUFER: Well, there's a certain -- I don't
19 remember the numbers. Okay? But there's a certain reported
20 volume every day of how many options are bought and sold. So
21 if you looked at the options he traded in our account and
22 then you multiply it -- I don't remember the numbers.

23 Let's suppose our accounts were for \$10 million,
24 and you assumed he had \$10 billion. So you multiplied
25 whatever he had in our account by a thousand. So you look at

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1 the volumes he executed in our account and made this very
2 large assumption that he had every account run the same way
3 and that he had in fact a thousand times the amount of money.

4 You could take the volumes he did in our account,
5 multiply it by a thousand, and compare that to the published
6 volume. And you saw -- I don't remember whether it was
7 larger or it was about the same size. It was just not
8 something you could do. There wasn't enough activity out
9 there.

10 He was doing more volume -- assuming; I keep
11 repeating this. Assuming that he was managing the amounts of
12 money we had heard that he might have been managing -- I
13 mean, we're in the business of doing executions. And we
14 could never conceive of doing such a large volume in the
15 standard way, in the standard market.

16 MS. STEIBER: You were just saying that you were
17 looking at the published option numbers. What if he were
18 doing it over the counter?

19 MR. LAUFER: That's much more delicate. Yes, it's
20 possible. You're entering into larger and larger
21 speculations here. I mean, I could tell you what we might
22 have speculated. So I'm comparing it to published volumes,
23 and it seemed to us you just couldn't do it.

24 But the people who trade volumes over the counter
25 are not stupid, and so they -- whatever they did would

1 reflect public -- would be reflected in the public volume.

2 And so --

3 MS. STEIBER: Explain that, how it's reflected in
4 the public volume.

5 MR. LAUFER: Well, you would see -- you could ask
6 your friends, traders. I'm sorry. Maybe I misspoke here.
7 And I'm also pushing. This is -- I'm not an expert here, so
8 I have to -- you know, this is not my field of expertise.

9 So you go down to our trading desk. All right?
10 And you say, gee, it looks like Madoff on these days, you
11 know, was executing volumes the same size as here.

12 Call up your friends in the options market and ask
13 them, is anybody buying and selling? Yes, it's possible that
14 somebody secretly was doing this. But, you know, this is
15 not -- there aren't that many big secrets. There was no --
16 there were no rumors of large volumes going on on these days.

17 Now, it's true it's possible. They could have been
18 somebody, somewhere.

19 MS. STEIBER: But unlikely?

20 MR. LAUFER: Well, in retrospect, no.

21 (Laughter.)

22 MR. LAUFER: But it struck us as unlikely. That's
23 all I can say. These were sort of wild guesses.

24 MR. KOTZ: And so as a result of this, what were
25 your --

1 MR. LAUFER: Finally, the last thing he did was he
2 did not do this every -- I don't remember whether his cycle
3 was monthly or quarterly. He did not do this every month or
4 every quarter. And it seemed to us that the quarters --
5 let's say it was quarterly; I don't remember -- the quarters
6 that he did not participate -- in other words, sometimes his
7 position would go to zero.

8 It seemed to us that the quarters that he'd decide
9 to go to zero were exceptionally good quarters to have no
10 position. So he seemed to have some predictive value for the
11 market as a whole.

12 MS. STEIBER: Explain -- explain that. I don't
13 understand when you say the quarters went to zero.

14 MR. LAUFER: As I said, first of all, I keep
15 repeating this because -- I don't remember whether he
16 would -- his reports, whether the trading would have a
17 quarterly cycle or a monthly cycle. Let's suppose it's a
18 quarterly cycle.

19 So the idea was -- we're the peers. At the
20 beginning of the quarter -- and I don't remember if this was
21 a calendar quarter or an option cycle quarter -- at the
22 beginning of the quarter, he would put out a position, a
23 position consisting of buying stocks and establishing an
24 option portfolio.

25 At the end of the quarter, he would typically

1 unwind the position and establish a new position. Now,
2 sometimes, if I remember correctly, he would keep that
3 position for another quarter without any trade ever quarter.
4 But sometimes, after unwinding the position, he would not
5 reestablish a new position. He would have positions of all
6 zero, and the account would show zero balance -- I'm sorry,
7 zero cash.

8 MS. STEIBER: So it was (inaudible) cash.

9 MR. LAUFER: Only cash. It seemed to us that those
10 quarters in which he decided to go into zero cash were
11 quarters in which, if you blindly tried to do what he was
12 doing, you would have lost money, it seemed to us.

13 So he seemed to be very good at predicting when his
14 basic strategy would make money or lose money. We had no
15 idea how he -- we had no speculation how he managed to do
16 that.

17 MR. KOTZ: And in your experience, had you seen,
18 you know, other examples of people being able to do that to
19 that degree?

20 MR. LAUFER: The quick answer is no, but the better
21 answer is it's not very easy or we don't have access to
22 people's managed accounts. So this was not -- it's not too
23 often that we get an opportunity to see what a trader is
24 doing.

25 MR. KOTZ: Okay. And so what was your kind of

1 initial conclusion from looking at this?

2 MR. LAUFER: We didn't understand what he was
3 doing. We didn't understand how he was doing what he was
4 doing. Maybe that's the same statement.

5 MR. KOTZ: Okay. And so what would that mean,
6 necessarily? It's just -- it's a matter of you guys not
7 being comfortable because of your lack of understanding?

8 MR. LAUFER: Yes. That's probably a fair
9 statement.

10 MR. KOTZ: Okay. And then did you have any
11 suspicions about what could be happening?

12 MR. LAUFER: Well, the suspicions that I had -- I
13 don't want to speak for other people -- were questions of,
14 you know, front-running. In other words, I didn't -- okay.
15 We didn't understand -- there are several things we didn't
16 understand.

17 So first of all, we didn't -- let's break it up
18 into stock trading and options trading. I know more about
19 the stock trading than about the options. Let's take the
20 options trading first. So we didn't understand the volumes
21 that he was doing, how he managed to do those volumes.

22 MR. KOTZ: Right.

23 MR. LAUFER: You have to ask who took the other
24 side. And since Madoff was such a profitable trader, why
25 would anybody want -- so if you -- once you -- once you leave

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1 the public trading, okay, like I said, there seemed to be
2 absolutely no way he could do this on the exchange trades or
3 the standard over-the-counter method because there wasn't the
4 volume there.

5 MR. KOTZ: Right.

6 MR. LAUFER: Then you ask, well, suppose he did it
7 through private parties? Since Madoff was well-known to have
8 very steady returns, why would anybody take the other side of
9 a Madoff trade? Or if they did, they would be exceedingly
10 careful.

11 MR. KOTZ: Okay.

12 MR. LAUFER: So we don't understand how he managed
13 to execute the options.

14 MS. STEIBER: So you didn't really think he was
15 trading options?

16 MR. LAUFER: No.

17 MS. STEIBER: Or (inaudible)? No?

18 MR. LAUFER: We didn't understand -- to say that we
19 didn't think is -- we didn't understand.

20 MS. STEIBER: You didn't understand how he traded
21 options, but you still thought he was trading options? Did
22 you suspect --

23 MR. LAUFER: You're asking me what I thought four
24 or five years ago. All I can say is I thought he was somehow
25 managing to do that, but I didn't understand how he was doing

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1 it. I didn't understand why he was doing it. I didn't
2 understand many things. But it did not occur to me that he
3 was -- there was some possibility he wasn't doing it. But I
4 don't know, it was very strange.

5 MR. KOTZ: So when you said there's some
6 possibility he wasn't doing it, you mean not trading the
7 options at all?

8 MR. LAUFER: Doing something else. I don't know.
9 We didn't -- we weren't sure what he was doing.

10 MS. STEIBER: Because you said you didn't see the
11 volume on the -- on CBOE.

12 MR. LAUFER: Yes.

13 MS. STEIBER: So you knew he wasn't trading options
14 (inaudible).

15 MR. LAUFER: Well, we couldn't see how he could
16 possibly be doing them there.

17 MS. STEIBER: And then you couldn't see how he
18 could be trading the options (inaudible).

19 MR. LAUFER: Well, that was different. We couldn't
20 see -- we didn't understand how he could be doing it because
21 of the various things that I said that -- we made inquiries.
22 We didn't see anybody saying he did a lot of trading. We
23 didn't understand why anybody in the business of options
24 would take the other side.

25 MS. STEIBER: Right.

1 MR. LAUFER: But it doesn't mean that somehow --
2 look. I mean (inaudible).

3 MS. PORTER: You're doing fine.

4 MR. LAUFER: Suppose you weren't me, and you didn't
5 know that Renaissance was legitimate, and you saw the
6 Renaissance returns. You would say, they couldn't do what
7 they were doing. Everything that I was saying about Madoff
8 you would say about Renaissance.

9 MR. KOTZ: Well, what about the aspect of looking
10 at where the options trading could have been? I mean, what
11 about that other aspect? Wasn't it more than just the
12 returns, but the fact that you just didn't see the volume?

13 MR. LAUFER: Yeah. Why didn't they -- you're
14 asking me. Of course.

15 MR. KOTZ: Right. Well, that's what I'm trying to
16 get at.

17 MR. LAUFER: But why should we go -- I mean --

18 MR. KOTZ: No, no. I'm not suggesting you should
19 have done anything. I'm just trying to understand it from
20 the eyes of the regulator. In other words, what I'm trying
21 to understand is: Shouldn't the regulator have looked at it
22 the same way --

23 MR. LAUFER: Yeah.

24 MR. KOTZ: -- and seen the lack of volume, and not
25 only thought perhaps there was some front-running, but

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1 perhaps there wasn't trading at all? I mean, isn't that
2 something that --

3 MR. LAUFER: That was small possibility, that
4 somehow --

5 MR. KOTZ: I mean, that would be one of the logical
6 conclusions that one would come to if you saw what you saw
7 (inaudible) somebody who had the --

8 MR. LAUFER: But excuse me, let me -- I apologize.
9 Let me ask you something (inaudible).

10 MR. KOTZ: -- somebody who had the (inaudible)
11 responsibility. But I'm just saying --

12 MR. LAUFER: Something much simpler. You don't
13 have to ask that question.

14 MR. KOTZ: Okay.

15 MR. LAUFER: You ask: Who took the other side of
16 the trade? You don't have to deduce huge amounts. Just ask
17 who took the other side of the trade, which of course we
18 couldn't find that.

19 MR. BARRON: All right. You didn't have the power
20 to do that.

21 MR. KOTZ: Right. Right. No, I understand.

22 MR. BARRON: A regulator might have had the power
23 to go to Madoff and say, who's on the other side of your
24 trades.

25 MR. LAUFER: And that would answer all the

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1 questions, you know, who took it, or maybe he didn't do it,
2 or --

3 MR. KOTZ: I mean, and don't you think that if you
4 had done kind of a thorough review, you would have had to
5 have asked that question as a regulator?

6 MR. LAUFER: Yes. I would think so.

7 MS. STEIBER: You had just been talking about the
8 options trading.

9 MR. LAUFER: Yes.

10 MS. STEIBER: And then you said you were going to
11 move on to --

12 MR. LAUFER: (Inaudible) stock trading, which I
13 know more about, both because I trade them -- (inaudible)
14 trade them but, you know, I'm closely involved with that, and
15 because I was more closely involved with that part of the
16 analysis.

17 So again, you look at the fills. Now, these are --
18 I have to say -- well, which you may not know about, I mean,
19 technical stuff. If you look at the fills for the stocks,
20 they are very, very good in terms of he's buying at the low
21 and selling at the high, which is extraordinarily hard to do.
22 And we would have loved to figure out how he did it so we
23 could do it ourselves. And so that was very suspicious.

24 And then you can make better guesses on that
25 because you can say, well, the guess was that he's in the

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1 stock trading business, and he was somehow cherry-picking the
2 trades that he ran through his company, which he shouldn't
3 have been doing. But that's -- there are ways -- not only
4 wouldn't we do this, we couldn't do this. But there are ways
5 you can guess what you would manage. And then you ask why he
6 did it. But you could guess.

7 And this is also a question of volumes here, too.
8 So for a small account, you could somehow manage to imagine
9 that he has this whole big operation, and he picks off a few
10 trades and he puts them in, and he could physically do it.
11 But you have to wonder whether he could do it for a large --
12 I don't know.

13 MS. STEIBER: Why would you wonder how he could do
14 it for a large group of trades? As his organization got
15 bigger, why is it less likely that he could be
16 cherry-picking?

17 MR. LAUFER: Okay. Now, I'm guessing -- no, I'm
18 saying. I'm not -- okay. If you don't know what he was
19 doing (inaudible) do anything. Okay. But you're asking what
20 he could have been doing if he was a crook. I mean, I'm
21 sorry, let me rephrase this.

22 Suppose that I decided to be a crook and I wanted
23 to produce statements of this type. How could I do that?
24 Okay. So here we run an operation, a trading -- a brokerage
25 firm. Then there are trades that run through. And some of

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1 them will be buys at the lowest of the day, and some of them
2 will be sells at the highest of the day.

3 And you could give those -- which you shouldn't
4 do -- you could give those trades to individual customers.
5 But the number of trades you're doing at the bottom of the --
6 bottom price, that's determined by your organization. And if
7 you had many, many customers, you may not have enough trades.

8 MS. STEIBER: Wouldn't your customers be more
9 likely to notice if you're doing a huge amount of
10 cherry-picking (inaudible)?

11 MR. LAUFER: No, because each customer is small.
12 You're not following me here.

13 MS. STEIBER: Why don't you explain, then. My
14 understanding, would you agree that it would be easy for him
15 if he were just running, let's say, a few million dollars, to
16 be cherry-picking where the account is small (inaudible).

17 MR. LAUFER: Only because -- only compared to the
18 fact that his main brokerage operation was presumably running
19 hundreds of millions of dollars of trades every day. The
20 number of trades that -- it doesn't matter.

21 (Inaudible) you have an organization. All right?
22 Merrill Lynch or whoever, Goldman Sachs. There could be a
23 lot of trades throughout the day. And some of those trades
24 will be buys at low prices. Now, the question is, which
25 customer gets that? Presumably the person who put that order

1 in, or if your instructions were to buy throughout the day,
2 you would get the certain fraction of those.

3 So some customers would get that because they were
4 smart or lucky. Okay. But if you were a crook, you
5 presumably could take those trades and give it to some
6 favorite customers. But if you are -- if every customer were
7 favored, you couldn't, because only some small fraction of
8 the trades were (inaudible).

9 So it's a question of scale, of how many customers
10 you have versus how many you want to cherry-pick.

11 MR. BARRON: That's if you consider -- if you
12 assume a normal distribution. Right? Of the trades?

13 MS. PORTER: It doesn't matter.

14 MR. LAUFER: It doesn't matter. In this
15 instance --

16 MR. BARRON: It doesn't matter?

17 MR. LAUFER: No. If -- yes and no. You don't have
18 to make such a fine statement.

19 MS. PORTER: They were all managed accounts. It
20 wasn't a fund. They were individual managed accounts. It
21 wasn't a fund.

22 MR. BARRON: Okay. Okay.

23 MS. PORTER: So there are only so many top trades.
24 Right?

25 MR. LAUFER: Yes.

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1 MS. PORTER: So who's getting them? Because
2 they're not going into one pool. They're going into itty,
3 bitty accounts.

4 MR. BARRON: I understand.

5 MR. LAUFER: Okay. Now, there's another issue
6 here, which I don't -- which is very important technical --
7 speaking to somebody else, technical stuff. So when you
8 buy -- or when you buy or you sell an option, there's a fair
9 amount of risk associated with that, depending on whether or
10 not the underlying goes up or down.

11 And so if you are a purchaser, if you are involved
12 in an option trade, you are concerned about the underlying
13 risk regarding what will happen. And if it's an option on
14 General Electric or that General Electric will go up and
15 down, or if you're buying an option on a basket of -- a
16 basket of (inaudible) stocks, you're about (inaudible) go up
17 or down.

18 And the person who -- if you're buying an option,
19 the person who sells you an option would much rather give you
20 a better price, if you want it, in terms of there's a certain
21 fair bid/ask spread, if you like, that the person selling the
22 option is entitled to because he's taking a certain amount of
23 risk.

24 If his risk is less, he'll tend to give you a
25 fairer price. So if the person selling you the option has